



Directorate of  
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# International Economic & Energy Weekly

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1 July 1983

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**International  
Economic & Energy  
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**International  
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**Synopsis**

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**Perspective—Soviet Assistance to Non-Communist LDCs**

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For nearly three decades the Soviet Union has sought to gain influence in non-Communist Third World countries around the globe, mainly through the proffering of military and economic assistance. While experiencing some reverses, such as those in Indonesia, Egypt, Sudan, and Somalia, the permanence and resolve of the Kremlin's "penetration" strategy cannot be disputed.

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**USSR: Assistance to Non-Communist LDCs Up Sharply in 1982**

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Soviet military sales and economic aid commitments to non-Communist Third World countries rebounded strongly in 1982 from the low ebb of the year before, but they still remained below the high levels of 1979-80. Decisions to equip the Iraqi and Syrian armed forces largely accounted for the turnaround in Soviet arms sales. Economic aid pledges rose as a result of new agreements signed with Nicaragua and several hard-pressed black African clients.

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**Thailand: New Government, Old Economic Problems**

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Thailand continued its relatively strong economic performance in 1982, but Prime Minister Prem's new government still faces economic problems. Bangkok is under pressure from the IMF and World Bank to decrease consumer subsidies, improve agricultural productivity, increase manufacturing efficiency, and promote manufacturing exports. Although some economic reforms have taken place, others are meeting considerable domestic opposition.

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**Hong Kong: Deteriorating Economic Conditions**

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The economic climate in Hong Kong has deteriorated sharply during the past two months, largely because of waning investor confidence in the face of a possible Chinese takeover in 1997. Short-term prospects for an economic rebound are nevertheless good. Over the next five to seven years the continued political uncertainty surrounding the 1997 issue will restrain economic growth and deepen economic downturns.

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**Spain: The Challenge of Entry Into the European Community**



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Spain's Socialist government is pressing EC leaders to accelerate negotiations on Spain's entry into the Community. In order to prepare for entry into the Community, however, the ruling Socialists face the daunting prospect of restructuring industry, agriculture, and finance.



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**Perspective*****Soviet Assistance to Non-Communist LDCs***

For nearly three decades the Soviet Union has sought to gain influence in non-Communist Third World countries around the globe mainly through the proffering of military and economic assistance. While experiencing some reverses, such as those in Indonesia, Egypt, Sudan, and Somalia, the permanence and resolve of the Kremlin's "penetration" strategy cannot be disputed. Indeed, the growing instability and armed conflict in the Third World since the early 1970s has provided not only fertile ground for new Soviet successes (Angola, Ethiopia, and Nicaragua) but the opportunity to turn a handsome profit on LDC arms purchases and related services as well.

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Despite its occasional successes, and an apparent willingness to extend assistance to almost any developing nation, Moscow's Third World assistance programs continue to be circumscribed by the historic ties and political affinities of individual LDCs. As a result, Soviet arms sales and economic aid commitments have remained heavily concentrated among countries along the Soviet borders and in the Middle East. Together, this group of about one dozen countries accounts for 90 percent of Moscow's \$57 billion in total military transfers and three-fourths of the \$11 billion of economic aid disbursements to non-Communist LDCs. Some 80 other non-Communist recipients of Soviet assistance have shared the remainder.

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While the Soviet military and economic programs generally work in tandem, Moscow found early on that arms transfers were the most direct and fastest route to influence. Newly independent Third World states often could obtain economic relief from the West, but not military assistance that many clamored for most. Offering a wide assortment of weaponry, along with rapid delivery, free training, and generous repayment terms, the USSR soon parlayed its initial arms deals with Afghanistan and Egypt into a half-billion-dollar-a-year program. By the mid-1970s, the Soviet Union had become the world's second-largest supplier of military equipment, chalking up annual sales of \$5 billion; and in 1980-81, Moscow overtook the United States as the number-one arms seller to the Third World.

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The rapid growth in Soviet military transfers and the increasing concentration among Middle East clients were spurred originally by the 1967 and 1973 Arab-Israeli conflicts. The spectacular increases monitored since then, however, can be attributed largely to the soaring demand for new and better armaments from the oil-rich nations of the region and others with access to

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Arab wealth. Soviet willingness to make available many of its most modern weapons on short notice set the stage for full-scale competition with Western arms suppliers. [ ]

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To boost its arms sales campaign, the USSR added more and larger carriers to its merchant fleet, and in 1975-76 began a construction program that would triple the size of its principal arms export facility in the Black Sea. The results have been impressive: the volume and value of Soviet arms transfers more than doubled in 1978-82 compared with the previous five-year period. During this period almost three-fourths of the arms delivered—valued at \$23 billion—went to cash-paying Middle East customers. [ ]

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Military sales increasingly have become a critical component of the Soviet foreign trade. Arms transfers currently account for as much as two-thirds of total Soviet exports to the Third World and earn Moscow an estimated \$6-7 billion in much-needed hard currency each year—about 15 percent of its total hard currency returns. Although receipts from arms deliveries may temporarily dip as a result of the falling oil revenues of major Soviet clients, huge order backlogs for Soviet weaponry ensure that cash earnings from this source will remain a constant, if not a growing, share of Moscow's hard currency income. [ ]

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Despite the overwhelming emphasis on arms transfers, Moscow still considers its economic aid program an important, low-cost instrument in furthering its goals in the non-Communist LDCs. Economic aid often is more able to endure strains created by new political alignments and regime changes, the continuance of many Soviet programs in Egypt being a case in point. Another important spinoff has been the expansion in Soviet-LDC trade, largely because the aid programs opened new markets for Soviet capital goods that would not otherwise have found a market outside the Soviet Bloc. [ ]

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Soviet military and economic assistance to non-Communist LDCs rebounded strongly in 1982 from the low levels of the year before, as Moscow took steps to:

- Recoup lost prestige and influence in the Middle East.
  - Undercut the Indian arms diversification effort.
  - Ensure its position in key black African countries and the Caribbean.
- Decisions to equip Syria and Iraq with more weaponry, and record purchases by India explain the upturn in Soviet arms sales. Economic aid commitments rose as a result of generous pledges to Angola, Ethiopia, and Nicaragua. [ ]

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The upturn in Soviet assistance last year also brought major modifications in the conduct of Moscow's aid program. The worsening economic climate and increased competition from Western suppliers prompted a return to concessionary financing and a greater Soviet willingness to supply even more of its best armaments and production technology to LDCs. New Delhi will be a major beneficiary through its signing of a \$1 billion purchase agreement for

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production technology and the license to build Soviet MIG-27 fighter-bombers in India. Moscow's economic aid extensions in 1982 were also generous, particularly oil credits to Ethiopia and commodity and project assistance pledged to Nicaragua. [REDACTED]

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The USSR's arms sales and economic aid programs are vital to the preservation of its influence and strategic interests abroad. Shifts in program tactics, such as those seen last year, demonstrate Moscow's determination not only to protect current gains, but to take advantage of new penetration opportunities. Moreover, its arms sales have become an increasingly important financial asset. Given the priority Moscow attaches to arms sales and the huge backlog of undelivered orders, Soviet arms transfers are likely to remain at current high levels for the next several years. [REDACTED]

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## Briefs

### Energy

#### *Possible Energy Pricing Agreement Between Ottawa and Alberta*

US Consular officials in Calgary report that a tentative agreement has been reached between federal and provincial officials on modifications to the Ottawa-Alberta Energy Agreement of 1981. The most significant change involves the maintenance of the price for old oil—oil discovered before 1974—at the current level of \$24.14 (83 percent of the OPEC benchmark price). This decision abandons, temporarily at least, the provision of the National Energy Program which decreed that the price of old oil would be kept at a level not to exceed 75 percent of the world price. In addition, special old oil—oil discovered during the 1974-80 period—will receive the new oil reference price (that is, the world price). The agreement apparently will also allow increases in the domestic price of natural gas of \$0.20 per thousand cubic feet (tcf) in August 1983 and again in February 1984 and will institute an incentive price of \$3.30/tcf for natural gas exports to the United States at levels exceeding 50 percent of licensed volumes.

#### *British Oil Production Increasing*

British North Sea oil production—including natural gas liquids—averaged 2.3 million b/d in May, a 3-percent increase over depressed April levels. Oil production from the British sector of the North Sea has averaged 2.36 million b/d this year, up about 150,000 b/d from last year's average output. Except for the Brent field, which is undergoing scheduled maintenance, production in May probably was close to capacity. Many industry sources expect further increases in output later this year when four new fields—Magnus, South Brae, Central Cormorant, and Maureen—come on stream. These four fields will

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eventually have a combined production capacity of about 350,000 b/d, and their increased output will more than offset the anticipated decline in production from some older fields. [redacted]

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*Negotiations for Norwegian Gas*

[redacted] the British Gas Corporation is in a better position than the rival West European Continental consortium to obtain gas from Norway's Sleipner field. [redacted] while the consortium is still interested in purchasing Sleipner gas, the United Kingdom can offer a higher price to Norway because its proximity to the field will reduce transport costs. In addition, Sleipner gas has a very high carbon dioxide content, and the British Gas Corporation has apparently agreed to take delivery without removal of the contaminant. Such an agreement would allow the Norwegians to be more flexible on price since it will substantially lower their production costs. Negotiations for the sale of the gas from this field have been under way for several months, and it now appears likely the British Gas Corporation will be the final purchaser. The Norwegians also have stated that negotiations for gas from the huge Troll field could get under way some time in early 1984 if an agreement for the sale of Sleipner gas is concluded this year. [redacted]

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*Saudis Reduce Oil Price Subsidies*

Saudi Arabia is removing price subsidies on marine bunker fuels for Saudi flag shipping, which will gradually raise the cost to shippers to the full international price—now about \$180 per ton—by June 1984. Last month bunker prices doubled and are currently 60 percent of the international average. Saudi Arabia initially provided subsidies to encourage development of an efficient, Saudi-owned coastal shipping fleet, but over the years Saudi long-distance shippers were allowed to make unauthorized purchases of the subsidized fuel.

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**International Finance**

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*West Germany  
Approves Major Loan  
for East Germany*

Bonn has decided to approve a five-year loan of 1 billion marks—about \$400 million at current exchange rates—from a group of West German banks to East Germany. East Germany will pay 1 percentage point over LIBOR. In recent years, East Berlin has been able to secure only much smaller loans maturing in two years or less. If it fails to make scheduled principal or interest payments, East Germany agreed to forgo fees from the West German Government for transit and some postal services. Bonn would use the funds to reimburse the banks. A West German official told the US Ambassador the agreement would bring West Germany no political concessions. The loan will ease East Germany's financial problems. It also will tend to confirm many Western bankers' belief in a West German financial umbrella and thus will encourage them to resume lending to East Berlin. The Kohl government, which in general has been unable to reach a consensus on what counterconcessions it should demand for aiding the East German economy, emphasized the approval of all parties in the coalition as well as the backing of the opposition Social Democrats for this specific arrangement.

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*Hungary Accedes to  
IMF Proposals*

According to US Embassy reports, Hungarian policymakers have resolved to advance the timetable for actions to ease the country's continuing financial crisis. The decision, reportedly made in April but as yet not announced publicly, is seen as a victory by Hungarian bankers who support recent IMF conclusions that stabilization/reform programs are moving too slowly. The Ministry of Finance and central planners had hoped to postpone any "major" resolution of the issues until the next party congress in 1985. The new stabilization package is expected to be approved formally by the Central Committee in August and implemented next spring. Presently lacking details, it apparently will incorporate IMF proposals to increase exports, in part by a further small devaluation of the forint; cut back again on consumer price subsidies; and more effectively reorient wage and tax systems toward gains in labor productivity and efficiency.

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*Moroccan Financial  
Prospects Improve*

Morocco and the IMF are close to agreement on a \$250-300 million standby loan that could be signed by early August, according to a reliable Embassy source. The standby probably will require deep budget cuts, devaluation of the dirham, and reductions in food subsidies—a politically sensitive issue which could ignite riots similar to those in Casablanca in June 1981 that claimed some 100 lives. Implementation of the IMF reforms, however, probably will

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not occur until after government elections scheduled for early September. The IMF loan will provide relief for Rabat's financial crunch; foreign exchange reserves cover less than one week of imports. In addition, the World Bank and Saudi Arabia will consider major new loans after the IMF accord is signed. [ ]

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*IMF-Mandated  
Austerity and Labor  
Unrest in Panama*

The general strike in Panama earlier this week comes at a time when continued economic stagnation and IMF-mandated austerity measures have limited the government's ability to appease angry workers. Although IMF approval this week of an 18-month, \$163 million standby loan and a \$64 million compensatory financing facility will improve the foreign payments situation, Fund restrictions on government spending will likely prompt Panama City to resist workers' bonus demands. Trade union leaders oppose the proposed revision of the country's labor code and demand the return of the portion of the wage bonus now paid to the Social Security Administration. Originally these funds, plus interest, were to be returned to the workers after 10 years. Should the labor issues remain unresolved much longer, however, the National Guard could preempt the civilian leadership in negotiating with the unions. [ ]

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**Global and Regional Developments**

*EC Steel Decision  
Postponed*

The EC Industry Council last week failed to agree on new steel production quotas and extended the current system, which had been due to expire on 30 June, for another month. The EC Commission wants the quotas extended until the end of 1985, when national and EC financial aids to the industry are to be phased out. West Germany, Italy, Belgium, and the Netherlands, however, want only a six-month extension. The negotiations also are complicated by the demands of Bonn, London, and Paris for larger quotas than the Commission is proposing. [ ]

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Although EC members continue to fight over quota levels, the system of production controls almost certainly will remain in effect indefinitely. All members agree that, without such controls, cutthroat competition could cause more steel plants to be closed. At the next Industry Council meeting on 25 July, the Commission is likely to offer some increase in quotas to the West Germans, French, and British. Most of the increase, however, probably will come at the expense of other members' quotas. [ ]

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*NIC Trade Surplus  
With OECD*

Increased exports and lower imports have led to a sharp increase in the trade surplus of the newly industrializing countries (NICs) with the OECD since the third quarter of last year. For the Asian NICs, the trade balance improvement came in the first quarter of this year as seasonally adjusted exports rose 12 percent from the previous quarter. Hong Kong recorded the largest export gain, with sales of garments and textiles to the United States leading the way. The debt-troubled Latin American NICs (Mexico and Brazil) increased their trade

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**NICs Trade Balance With the OECD,<sup>a</sup>**  
**Seasonally Adjusted**

Billion US \$

	1981	1982					1983 <sup>b</sup>
	Total	Total	I	II	III	IV	I
<b>NICs</b>							
Exports	75.4	77.4	18.9	19.4	19.9	19.2	20.5
Imports	82.6	71.6	19.5	18.4	18.1	15.6	16.2
Balance	-7.2	5.8	-0.6	1.0	1.8	3.6	4.3
<b>South Korea</b>							
Exports	11.7	12.0	3.0	3.1	3.1	2.8	3.1
Imports	13.5	13.1	3.1	3.1	3.4	3.5	3.5
Balance	-1.8	-1.1	-0.1	0	-0.3	-0.7	-0.4
<b>Taiwan</b>							
Exports	14.4	14.8	3.6	3.8	3.8	3.6	4.0
Imports	11.8	10.8	2.8	2.7	2.6	2.7	2.5
Balance	2.6	4.0	0.8	1.1	1.2	0.9	1.5
<b>Singapore</b>							
Exports	6.1	6.0	1.5	1.6	1.4	1.5	1.4
Imports	11.0	11.5	2.9	2.8	3.0	2.8	2.9
Balance	-4.9	-5.5	-1.4	-1.2	-1.6	-1.3	-1.5
<b>Hong Kong</b>							
Exports	11.8	11.4	2.8	2.9	2.9	2.8	3.5
Imports	12.1	11.4	3.1	2.9	2.8	2.6	2.6
Balance	-0.3	0	-0.3	0	0.1	0.2	0.9
<b>Brazil</b>							
Exports	12.7	12.8	3.3	3.3	3.1	3.1	3.1
Imports	9.3	8.0	2.1	2.2	2.1	1.6	1.7
Balance	3.4	4.8	1.2	1.1	1.0	1.5	1.4
<b>Mexico</b>							
Exports	18.7	20.4	4.7	4.7	5.6	5.4	5.4
Imports	24.9	16.8	5.5	4.7	4.2	2.4	3.0
Balance	-6.2	3.6	-0.8	0	1.4	3.0	2.4

<sup>a</sup> NIC exports to the OECD were derived by dividing OECD imports from the NICs by 1.1, while NIC imports were obtained using OECD export data. Both import and export data are valued f.o.b.

<sup>b</sup> For some OECD countries first-quarter data are estimates.



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surplus with the OECD in the last two quarters by cutting back imports. For the remainder of 1983, Mexican and Brazilian imports from the OECD are likely to remain at depressed levels, but exports to the OECD may show some improvement; Brazil's currency devaluations should help exports, and recovery in the United States will boost earnings, particularly for Mexico. The Asian NICs will also probably further expand their sales to the OECD as recovery in the developed countries stimulates demand for manufactures. [ ]

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*New Israeli Monetary  
Controls in West Bank*

An Israeli press report states that residents of the West Bank and Gaza will no longer be able to write checks on bank accounts in Arab countries. According to the press report, the measure was taken to control funds that could be used for subversive activities. Last week a West Bank newspaper reported that Israeli authorities were confiscating the personal checkbooks of money-changers as they crossed the bridges between Jordan and the West Bank. If the ban on Arab checks is enforced, it will create a hardship for many West Bank Arabs who keep their funds in banks in Amman. Recently imposed Jordanian restrictions on the entry of West Bank residents will complicate their efforts to get their money. The new Israeli measure may be an attempt to force residents of the West Bank to deal with Israeli banks. [ ]

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*Czechoslovakia  
Seeking Trade  
Concessions From EC*

Czechoslovakia last week approached the EC Commission to seek trade concessions. An EC Commission official predicts tough going for the Czechoslovaks, who want help in increasing exports of glassware, footwear, ceramics, tractors, and other products. In April Hungary asked the EC for a trade agreement and raised the possibility of a free trade area and other preferential arrangements. Romania signed a limited trade arrangement with the EC in 1978. [ ]

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In the absence of any progress toward an EC-CEMA agreement, Moscow apparently has not opposed individual approaches by Prague and Budapest. Although Czechoslovakia's hard currency problems are less serious than those of other East European countries, Prague would like additional markets in the EC to increase export earnings. Czechoslovakia is less likely to win EC concessions than Hungary because of the EC's interest in giving the more politically moderate Hungarians special consideration. [ ]

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*Cocoa Prices  
Continue Upward*

Cocoa prices have reached a 39-month high on news of continued production problems in West Africa, which accounts for over half of world exports. Drought and brush fires in the region, as well as the recent coup attempt in Ghana, the second-largest exporter, have fueled speculative price increases on cocoa futures markets. Ghanaian cocoa production has been declining because of a failing transportation network, inadequate producer incentives, and, more recently, poor crop management. [ ]

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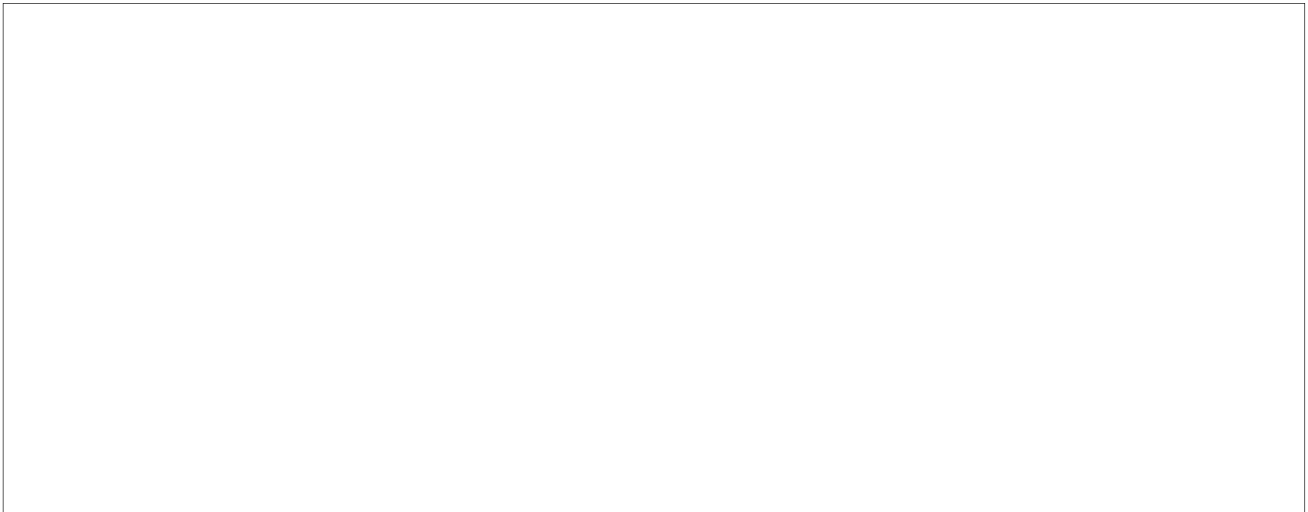
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Stimulated by the strengthening Western recovery, world cocoa consumption this year will exceed production for the first time since 1977. Output will be the lowest in three years, but cocoa bean stocks remain at near-record levels. Long-term prospects for cocoa production remain strong. While West African cocoa supplies will play a reduced role in world markets, Brazil, Malaysia, and several other Southeast Asian countries are expected to pick up the slack.

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## National Developments

### *Developed Countries*



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#### *Restraints on Japanese Auto Exports to Canada*

Canadian Trade Minister Regan announced this week that Japan has voluntarily agreed to limit its automobile shipments to Canada to 202,600 units in the 15-month period ending 31 March 1984, the same total as in the previous 15-month period. The agreement satisfies one of the major demands of the recent highly publicized task force report on the status of the domestic automobile industry. The report called for the continuation of import restrictions on Japanese automobiles until regulations on Canadian content are implemented. The task force, composed of industry and labor leaders, recommended that all automobiles sold in Canada should eventually have a 60-percent Canadian content. Negotiations between Japanese and Canadian officials on voluntary restraints, which had been in progress for several months, apparently were given additional impetus by the publication of the task force's report in May.

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#### *Portugal's Austerity Program*

The new coalition government is moving rapidly to deal with Portugal's pressing economic problems. In an effort to stem capital flight and stimulate worker remittances, Lisbon last week devalued the escudo by 12 percent against a basket of 18 currencies. Finance Minister Ernani Lopes subsequently

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announced a two-month freeze on government investment and price hikes ranging from 15 to 41 percent for subsidized foodstuffs. Another round of price increases for fuel and energy appears likely. The government has also won a vote of confidence in parliament for a program that maps out a somewhat vague strategy for stabilizing the economy. The program includes proposals to exert greater control over public-sector spending, allow private competition in some sectors of the economy, and revoke the Balsemao administration's 17-percent wage guideline. Prime Minister Soares is seeking the Assembly's approval this week to govern by decree during the summer recess. Such power would enable the government to enact further austerity measures—which would reduce real personal income and raise unemployment—without fear of parliamentary sabotage by the Communists.

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### ***Less Developed Countries***

#### ***Continuing Economic Pressures for Brazil***

Severe cash problems are eroding Brazil's ability to import and are deepening its recession.  many banks are reluctant to extend new trade credits and are gradually withdrawing their interbank

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deposits, which in recent weeks have declined some \$300 million. Export earnings have not been faring well because of sluggish demand. They will be further constrained by flood damage to soybeans and other crops in the south.

Brazil's import expenditures through last month were more than 20 percent below the same period last year, and inadequate supplies of key materials have forced manufacturers to scale back production. To meet the IMF-mandated \$6 billion trade surplus target, Brasilia will have to continue squeezing imports. The cut in imports and the unanticipated agricultural losses, combined with depressed demand, may lead to as much as a 5-percent decline in economic activity this year and raise unemployment to double digits. The growing recession will heighten government concerns about the potential for more labor unrest.

*Brazilian Government  
Wary of Discontent*

President Figueiredo is giving increased authority for economic decisionmaking to his principal political adviser, suggesting that the government will trim back austerity plans to reduce growing discontent.

the role of Joao Leitao, the head of the President's civilian staff, has expanded.

Leitao's influence has been increased partly as the result of the continuing disarray in the government's economic team, which may be headed for a shakeup. Planning Minister Delfim and Finance Minister Galveas favor more expansionary policies, while Central Bank President Langoni prefers the IMF-mandated austerity program. The prestige of all three has been lowered by their disagreements.

Leitao evidently is concerned about mounting signs of disgruntlement. Although many of the 100,000 federal workers on strike in early June have returned to work, recently announced new cuts in their benefits may spark more job actions. Private-sector workers also are staging sporadic walkouts and demonstrations. In addition, the US Embassy reports that the grumbling is spreading in the middle class and among middle-level military officers. The ascendancy of Leitao indicates that political considerations probably will play an ever greater role in economic policymaking, with or without changes in the economic team. Brasilia is afraid of aggravating public dissatisfaction and is likely to resist IMF demands for stronger action. Even if a new accord is reached with the IMF, political pressures will make it difficult for Brazil to adhere to tough austerity measures.

*Mexico's Balance of  
Payments Improves But  
Domestic Recession  
Deepens*

Austerity measures, devaluations, and deep cuts in trade financing have resulted in a sharp improvement in Mexico's balance of payments, but the resulting recession is provoking growing domestic economic strains. A two-thirds cut in imports produced a \$4.5 billion trade surplus in the first three months of this year. Despite continuing capital flight, new funds from the IMF

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and commercial banks have been sufficient to partially restore depleted financial reserves. Mexico was then able to postpone drawing of the second installment of the \$5 billion commercial bank loan that it arranged earlier this year. According to US Embassy reporting, Mexican financial officials planned to draw half of the available \$1.1 billion in late June and the rest soon thereafter. [ ]

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The economy is now in deep recession. Government outlays are dropping, bankruptcies and unemployment are multiplying, consumer demand is falling, and raw material shortages are growing. In addition industrial production is off sharply, and overall economic activity is falling at an annual rate of 5 to 6 percent. Nevertheless, inflation is staying near the triple digit range. A recent poll of private businessmen showed 76 percent of the firms project losses this year, 62 percent plan further layoffs, and 15 percent were insolvent. Bank of Mexico officials reported [ ] that middle-class incomes have declined 25 to 40 percent since the financial crisis began last year. [ ]

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*Philippine Austerity Measures*

To deal with his country's financial crisis, President Marcos last week announced that the peso will be devalued by 8 percent and that five major industrial projects will be canceled. Other large projects requiring foreign exchange will be subject to a strict review. In addition, Manila is eliminating domestic oil price subsidies. Both the devaluation and the elimination of oil price subsidies were promised in earlier negotiations for new loans with the IMF and World Bank. The US Embassy attributes the delay in implementing them to political pressures on Marcos, and it says that the postponement is largely responsible for the IMF's criticism last week of Philippine economic performance. The Embassy also reports that the balance-of-payments deficit for the first half of this year reached \$600 million—twice the government's target. [ ]

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Even with the austerity measures in place, Manila may have difficulty avoiding some form of foreign debt rescheduling. Some commercial bankers are already refusing to renew short-term credits, and others probably will be disturbed by the IMF's criticism. Manila is especially worried about any falloff of short-term credits. Its current short-term indebtedness may total twice the official figure of about \$4.5 billion, and its foreign exchange position is precarious. [ ]

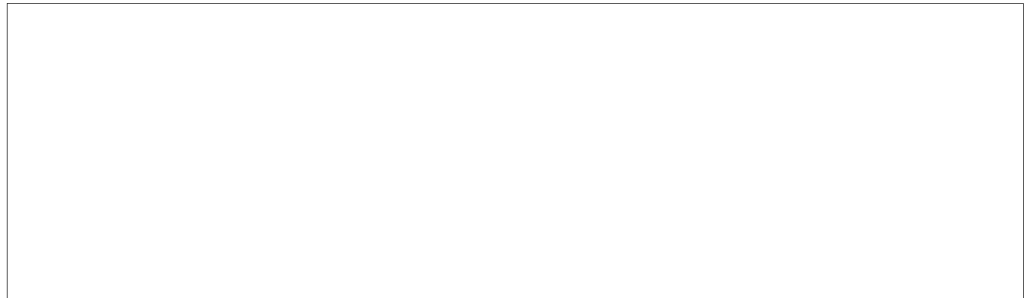
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*Iran Seeking Wider  
Foreign Contacts*

The US Embassy in Tokyo reports that Iranian Deputy Foreign Minister Ardebili recently indicated to Japanese officials that Tehran wants to improve its relations with some key industrialized nations. Ardebili said Iran was particularly interested in expanding contacts with Japan, West Germany, and Canada, although Canada would first have to apologize for its role in the US hostage crisis. He indicated that Iran has no intention of opening a dialogue with the United States and ruled out closer ties with France while it supplies arms to Iraq. Iran's imports from Western countries and Japan already have doubled during the first quarter of 1983—to over \$2.3 billion—compared with the same period last year. 


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The resurgence of Iranian oil revenues over the past year and Tehran's new emphasis on economic development will give Western countries and Japan new opportunities for trade with Iran. Tehran needs Western equipment, technology, and skilled labor to realize its economic goals. Political relations, however, are not likely to keep pace with expanded trade. Some Iranian leaders remain opposed to moves that would draw Iran closer to either the West or the East. 

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*Communist*

*New Soviet Law on  
Worker Participation  
in Management*

The Supreme Soviet at its mid-June session approved a new law—to take effect 1 August—that allows workers to participate in the management of enterprises. The law does not, however, give the workers any real power to improve their own welfare or play an active managerial role. The language of the law makes clear that the party will remain firmly in control and, regarding such critical matters as formulating enterprise plans, selecting managers, setting norms, and negotiating salaries, that workers will play a passive role. Workers, for example, are to “propose the names of workers as candidates for bonuses, discuss the state of labor discipline, and ratify the proposals of management and the trade unions on the internal organization of work.” 

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The new law does not differ significantly from the codes and regulations it supersedes. Its major substantive contribution is to clarify the functions and responsibilities of various commissions and volunteer groups in such areas as health, labor safety, and protecting state property. The law—proposed in draft form in April by the Council of Ministers and the All-Union Council of Trade

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Unions—indicates that Andropov is continuing efforts initiated by Brezhnev, largely in response to the labor turmoil in Poland in recent years, to introduce cosmetic changes that create the appearance of enhanced power for workers.

[REDACTED]

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*Record Soviet  
Meat Production*

Meat production on collective and state farms reached a record level during the first five months of this year—about 7 percent above the comparable period last year and 6 percent above the previous high achieved in 1978. The improved performance was largely due to a mild winter that reduced the need for feed followed by the early arrival of spring weather that further bolstered feed supply. Herd sizes are at record levels, and substantial growth in meat production is likely after three years of stagnation. Output this year could approach a record high of 16 million tons if grain production reaches an estimated 210 million tons and if there are grain imports of 20 million tons and ample supplies of forage crops. Even at this production level, however, 400,000 tons of meat would have to be imported in order to maintain per capita meat consumption at the level of 1982. Imports of 400,000 tons would be roughly half of the total in 1982.

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## USSR: Assistance to Non-Communist LDCs Up Sharply in 1982

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Soviet military sales and economic aid commitments to non-Communist Third World countries rebounded strongly in 1982 from the low ebb of the year before, but they still remained below the high levels of 1979-80. Decisions to equip the Iraqi and Syrian armed forces largely accounted for the turnaround in Soviet arms sales. Economic aid pledges rose as a result of new agreements signed with Nicaragua and several hard-pressed black African clients.

### Military Sales

New Soviet arms contracts reached \$9 billion in 1982, almost 50 percent higher than the year before and well above the average for the last five years. Nearly 90 percent of new orders were from Iraq, Syria, and India. Purchases by Libya, Kuwait, Afghanistan, Angola, Peru, and Nicaragua accounted for the bulk of the remaining sales.

Moscow modified the terms of sale for its arms in 1982 in light of the worsening economic climate and increased competition from Western arms suppliers. It offered concessionary terms, a growing list of its best armaments, and a rescheduling of debts. The military resupply accords signed with Iraq and Syria were indicative of Moscow's increased flexibility. In both cases, Moscow used its military assistance program to repair strained relations, and, in the case of Iraq, to prevent further loss of its arms market to France and other Western suppliers. In the latest arms agreements with Iraq and Syria, Moscow provided both easier repayment terms and new model T-72 tanks and high performance aircraft.

The Soviets also licensed the sale of some of its more advanced military production technology to a non-Communist country—India. The license to produce MIG-27 aircraft accounted for approximately one-third of the nearly \$3 billion worth of new Soviet-Indian agreements last year. This production program is an advance in the transfer of Soviet technology to a non-Communist country, both in terms of the advanced technology in the system and in terms of production methods.

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Although down from the 1981 levels, East European suppliers again capitalized on the continuing heavy demands generated by the Iran-Iraq war. About one-half of the \$1.2 billion in East European sales went to Iran and Iraq, with most of the sales coming from Czechoslovakia, East Germany, Poland, and Romania.

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### Arms Deliveries Also Surged Last Year

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The volume of Soviet military equipment deliveries increased substantially last year, spurred by record order backlogs and the heavy resupply efforts to Iraq and Syria. Almost 50 percent of the military tonnage shipped out of the Black Sea in 1982 went to those two recipients, with deliveries to Iraq tripling over 1981, when the short-lived Soviet embargo curtailed shipments. Except for jet fighters, nearly all categories of Soviet weapons deliveries showed sizable increases, especially surface-to-air missile launchers and artillery. Iraq also received record arms deliveries from Eastern Europe, worth over \$800 million and consisting mostly of high consumption items such as artillery ammunition, spare parts, infantry weapons, and transport

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**Secret****Soviet Bloc: Military and Economic Assistance Agreements  
with Non-Communist LDCs, 1982***Million US \$*

	Military		Economic	
	USSR	Eastern Europe	USSR	Eastern Europe
<b>Total</b>	<b>9,120</b>	<b>1,223</b>	<b>882</b>	<b>577</b>
Middle East/North Africa	5,706	1,134	NEGL	83
Algeria	0	3	0	0
Iran	11	207	0	0
Iraq	3,003	385	0	0
Kuwait	258	NA	0	0
Libya	386	362	0	0
Syria	2,012	36	0	0
Other	36	141	NEGL	83
Latin America	141	24	173	101
Nicaragua	35	24	163	84
Peru	106	0	0	0
Other	0	0	10	17
South Asia	3,136	31	75	280
Afghanistan	169	6	75	0
India	2,959	25	0	0
Other	8	NEGL	0	280
Sub-Saharan Africa	137	34	634	113
Angola	100	19	400	0
Ethiopia	10	0	170	0
Mozambique	2	10	5	10
Other	25	5	59	103

vehicles. Another \$200 million in Soviet Bloc equipment was shipped to Iran last year by Libya.

Arms deliveries to other Soviet recipients decreased last year, due in part to the resupply operations to Iraq and Syria. Protracted negotiations with Tripoli over late payments for arms may also have contributed to the slowing of shipments to Libya.

Although Angola, Mozambique, and Nicaragua accounted for only a small part of total deliveries, they received larger shipments of Soviet arms in

1982. Moscow bolstered the defenses of its southern African patrons because of their increased frictions with South Africa. Record shipments to Angola included the country's first guided-missile patrol boats and T-62 medium tanks. Two additional squadrons of MIG-21 fighters were also delivered. To better protect Mozambique's southern flank, Moscow sent new armored personnel carriers, tanks, and tracked bridging equipment.

Soviet deliveries to Nicaragua rose from \$6 million in 1981 to \$53 million last year. They included

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**USSR: Major Weapons Deliveries  
to Non-Communist LDCs, 1982 <sup>a</sup>***Number of units*

	Tanks	Other Armored Vehicles	Field Artillery	Naval Patrol and Missile Combatants	Jet Fighters and Trainers	Helicopters	SAM Launchers <sup>b</sup>
<b>Total</b>	<b>858</b>	<b>1,252</b>	<b>803</b>	<b>17</b>	<b>313</b>	<b>159</b>	<b>229</b>
<b>Middle East/North Africa</b>	<b>555</b>	<b>1,065</b>	<b>342</b>	<b>6</b>	<b>183</b>	<b>134</b>	<b>219</b>
Algeria	74	177	80	1	39	0	43
Iraq	221	NA	12	0	66	23	NA
Jordan	0	0	0	0	0	0	20
Libya	0	28	48	0	14	35	29
Syria	248	788	193	2	59	67	121
Other	12	72	9	3	5	9	6
<b>Latin America</b>	<b>19</b>	<b>0</b>	<b>12</b>	<b>1</b>	<b>4</b>	<b>6</b>	<b>0</b>
Nicaragua	19	0	12	1	0	1	0
Peru	0	0	0	0	4	5	0
<b>South Asia</b>	<b>140</b>	<b>59</b>	<b>189</b>	<b>0</b>	<b>105</b>	<b>19</b>	<b>10</b>
Afghanistan	140	59	175	0	14	15	0
India	0	0	14	0	91	4	10
<b>Sub-Saharan Africa</b>	<b>144</b>	<b>128</b>	<b>260</b>	<b>10</b>	<b>21</b>	<b>0</b>	<b>0</b>
Angola	39	4	24	4	20	0	0
Ethiopia	40	82	210	3	0	0	0
Mozambique	65	42	26	0	0	0	0
Other	0	0	0	3	1	0	0

<sup>a</sup> Minimum number identified.<sup>b</sup> Includes SA-2, SA-3, SA-6, SA-8, and SA-9.

additional T-55 tanks, the country's first BM-21 mobile rocket launchers, and mobile radio intercept stations to locate guerrilla communications sites. Cuba and East Germany augmented the Soviet shipments with anti-aircraft guns and transport vehicles. [redacted]

Overall deliveries to Cuba last year dropped only modestly from the 1981 peak, as Havana continued to upgrade its arsenal. Deliveries included MI-24 helicopter gunships, record numbers of MIG-21 and swingwing MIG-23 fighters, and additional naval craft. [redacted]

**Communist Clients**

The volume of Soviet military-related shipments to Communist LDCs increased slightly in 1982, on the strength of increased deliveries to Laos and Vietnam. [redacted]

**Economic Aid**

Moscow's economic aid commitments of almost \$900 million were up nearly 70 percent from 1981, dominated by large new pledges to three favored clients:

- Angola signed a \$400 million contract—under a framework agreement valued at \$2 billion—for a

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dam and powerplant that probably are to be financed with 10-year credits.

- Ethiopia received \$170 million in credits and grants to finance oil purchases from the USSR.
- Nicaragua received about \$165 million in new commitments for development projects, technical assistance, and emergency commodity assistance.

Disbursements of economic aid reached \$1.2 billion last year, a 40-percent increase over the prior record level of 1981. Commodity support to Afghanistan and Ethiopia and large deliveries to Nigeria and Pakistan for steelmaking projects were responsible for most of the increase in disbursements last year. About 42,000 Soviet economic technicians were employed in LDCs in 1982, with more than one-half working on projects in the Middle East and North Africa.

The USSR's economic aid to non-Communist LDCs remains a small fraction of that supplied to the Communist LDCs, mainly Cuba and Vietnam. Estimates on economic aid to Communist clients in 1982 range up to \$5-6 billion, much of it in the form of oil and sugar subsidies.

## Outlook

Its Third World aid program, especially military transfers, is vital to the preservation of the USSR's influence and strategic interests abroad. The mounting instability arising from the poor economic and financial conditions in most LDCs poses both new opportunities for penetration, and rising economic costs if Moscow is to maintain its present position among favored Third World clients.

In view of the political priority that Moscow attaches to its military aid program and the record amount of undelivered military orders of about \$22 billion, Soviet arms transfers are likely to remain at or near the current high levels for the next few years. Moreover, the expected deliveries will contain a wider array of newer and more advanced

weapons to a growing list of customers. The availability of advanced weapons and an apparent increased willingness to offer concessionary terms will help offset recent efforts by some of Moscow's largest buyers to diversify their inventory purchases.

Soviet willingness to sell arms on concessionary terms probably will reduce hard currency earnings somewhat. Returns from military sales nevertheless will continue to be an important source of Moscow's hard currency earnings.

We expect Moscow's commitments for economic assistance to stay near the billion-dollar level this year. New pledges, however, probably will be allocated to a more select group of Soviet-oriented regimes.

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## Thailand: New Government, Old Economic Problems

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Thailand continued its relatively strong economic performance in 1982. Its 4.2-percent economic growth rate and 50-percent decrease in the current account deficit contrasted sharply with the performance of most other countries. Prime Minister Prem's new government still faces economic problems, however. The global recession has slowed the domestic economy, and Bangkok is under pressure from the IMF and World Bank to decrease consumer subsidies, improve agricultural productivity, increase manufacturing efficiency, and promote manufacturing exports. Although some economic reforms have taken place, others are meeting considerable domestic opposition. Bangkok is delaying utility price increases because of concern over public protests, and progress in reducing tariffs and streamlining foreign investment procedures is being slowed by entrenched business and military interests. Moreover, shortfalls in natural gas production threaten the development of a major industrial complex.

### Economic Performance

The new government, which took office in early May, inherits an apparently healthy economy by world standards:

- For the past two decades economic growth averaged 7 to 8 percent annually.
- Per capita income rose about 4 percent a year over the same period to about \$760 in 1982, placing Thailand well in the ranks of middle-income developing countries.
- Agricultural output has grown to the point where Thailand is a net food exporter—and the world's leading rice exporter.
- Unemployment is low—officially at 6 percent.
- The country has a good international credit rating with a manageable debt service ratio of only 16 percent.

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### *Behind Thailand's Economic Growth*

*Both the agricultural and manufacturing sectors played roles in Thailand's economic success. During the past 20 years, agricultural output grew more than 5 percent a year, largely from the extension of arable land. At the same time government policies restricting rice exports encouraged farmers to diversify into other crops, especially sugar, corn, and tapioca. By 1982, Thailand had become the world's fifth-largest sugar exporter and a growing presence in the international corn trade, exporting over 2 million tons last year. (U)*

*Since 1960 the manufacturing sector expanded by more than 10 percent a year, transforming a basically rural economy into one in which the share of manufacturing in total production nearly equals the share of agriculture. Manufacturing exports—garments and increasingly electrical components—now account for 15 percent of export earnings. As additional evidence of the economy's adaptability, the tourist industry now earns as much foreign currency as rice exports, and overseas workers send home more than \$500 million a year, according to the Bank of Thailand.*

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Beneath this robust exterior, however, there are some serious difficulties stemming both from the global recession and, more importantly, from internal structural problems. Last year's 4.2-percent economic growth and remarkable improvement in the balance of payments—with both the current account and trade deficits falling by more than \$1 billion—cloak a substantial slowdown in the domestic economy. Agricultural production stagnated

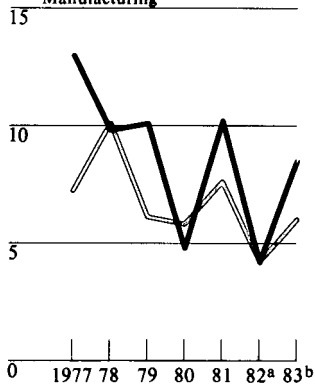
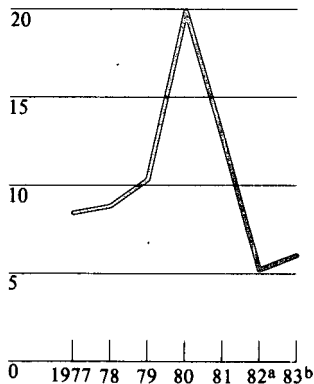
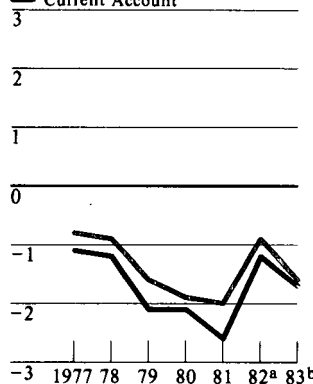
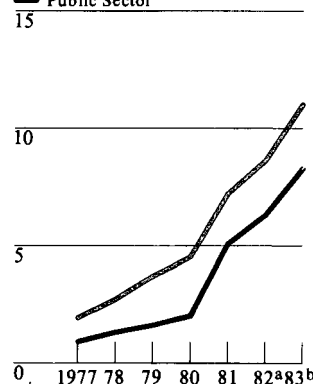
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**Thailand: Economic Indicators**

Note scale change

**Production Indicators**  
Percent— GDP Growth  
— Manufacturing**Inflation Rate**  
Percent**Balance-of-Payments**  
Billion US \$— Trade Balance  
— Current Account**Foreign Debt<sup>c</sup>**  
Billion US \$— Total  
— Public Sector<sup>a</sup> Estimated.<sup>b</sup> Projected.<sup>c</sup> Excludes short-term debt.

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because of drought in some growing areas and reduced plantings due to low crop prices. Depressed foreign and domestic demand cut manufacturing growth from 10 to 4 percent, and together with high real interest rates led to a nearly 15-percent drop in real private-sector investment, despite a condominium construction boom in Bangkok. The economic slowdown would have been even sharper had<sup>3</sup> Bangkok not boosted government spending by 17 percent and public-sector investment by 6 to 7 percent. The other major factor propping up demand was a 4-percent rise in export earnings, resulting from a 10-percent rise in export volume, despite a precipitous drop in international commodity prices. [ ]

More important for the longer term, World Bank analysts believe Thailand's growth potential along previous lines is largely exhausted. Increases in area under cultivation were responsible for about one-fourth of total GDP growth over the last decade, but most good agricultural land is now

under cultivation. Segments of the manufacturing sector—especially basic consumer goods, which developed behind moderately high tariff barriers—are inefficient and unable to compete in international markets. Planned fertilizer and petrochemicals plants probably would also be uncompetitive. In addition, more than one-fourth of the population, principally in the north and the northeast, live in poverty, and the income disparity between metropolitan Bangkok and the rural areas is growing. [ ]

**Economic Challenges**

Slow to adjust to the second round of OPEC oil price hikes in 1979-80, Thailand's balance of payments deteriorated sharply as the value of oil imports doubled to \$2.5 billion between 1978 and 1981, absorbing nearly 40 percent of export earnings. As a result, the current account deficit also

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**Thailand: Balance of Payments**

Million US \$

	1977	1978	1979	1980	1981	1982 <sup>a</sup>	1983 <sup>b</sup>
<b>Current Account</b>	<b>-1,098</b>	<b>-1,154</b>	<b>-2,087</b>	<b>-2,078</b>	<b>-2,556</b>	<b>-1,251</b>	<b>-1,720</b>
Trade balance	-784	-859	-1,551	-1,903	-2,032	-930	-1,600
Exports f.o.b.	3,454	4,045	5,234	6,449	6,898	7,170	7,300
Of which:							
Rice	656	513	764	953	1,208	950	1,050
Sugar	365	195	235	145	441	564	600
Tapioca	378	535	484	727	754	696	700
Rubber	302	395	605	603	500	406	600
Tin	223	356	453	554	423	377	500
Corn	159	208	276	356	382	429	500
Manufactures	NA	NA	699	886	830	1,014	1,170
Imports f.o.b.	4,238	4,904	6,785	8,352	8,930	8,100	8,900
Of which:							
Oil	937	1,016	1,423	2,552	2,519	2,352	2,000
Services (net)	-398	-439	-783	-760	-1,169	-930	-800
Transfers (net)	84	144	247	585	645	609	680
<b>Capital Account</b>	<b>726</b>	<b>489</b>	<b>1,743</b>	<b>2,351</b>	<b>2,446</b>	<b>1,332</b>	<b>1,700</b>
Net long-term	428	646	1,477	2,107	2,352	1,602	2,000
Direct investment	106	50	51	189	288	179	225
Net short-term <sup>c</sup>	298	-157	266	244	94	-270	-300
<b>Balance</b>	<b>-372</b>	<b>-665</b>	<b>-344</b>	<b>273</b>	<b>110</b>	<b>81</b>	<b>-20</b>
Foreign exchange reserves <sup>d</sup>	1,915	2,557	3,129	3,026	2,727	2,729	2,900

<sup>a</sup> Estimated.<sup>b</sup> Projected.<sup>c</sup> Includes errors and omissions and allocations of SDRs.<sup>d</sup> End of period.

doubled to \$2.6 billion—over 7 percent of GDP—and foreign borrowing expanded by 70 percent, mostly to pay for imported oil.

As part of an IMF/World Bank financing package designed to help fund these deficits, the IMF's \$288 million standby loan for 1982-83 requires Thailand to limit the growth of domestic credit and reduce the budget deficit. The World Bank—Thailand's largest creditor—in 1981 granted an

approximately \$1 billion, five-year structural adjustment loan in return for Bangkok's commitment to reduce tariffs, improve manufacturing efficiency, and promote rural development and labor-intensive, export-oriented manufacturing.

Some of the reforms called for by the IMF and the World Bank will require difficult, politically sensitive economic decisions by the new Prem government. Prem's biggest economic headache is the size

**Secret****Thailand: IMF/World Bank Loan Conditionality**

Lender	Loan Description	Conditions	Comments
IMF	A \$288 million balance-of-payments standby loan for 1982-83.	Reduce fiscal deficit, limit domestic credit creation, and hold debt service ratio for public and publicly guaranteed foreign debt to 9 percent.	Debt service is just below the ceiling; money supply growth is down because of low demand. 1983 fiscal deficit above that of 1982.
World Bank	\$110 million loan for railroad expansion and modernization.	An increase in passenger and freight charges to reduce the deficit of the State Railways of Thailand (SRT).	A 7-percent passenger fare hike proposed early this year was withdrawn by Prem before the April election. The Bank, which is holding up the loan, wants a 10-percent increase implemented by September. Communications Minister Samak has proposed a 7-percent increase for late June.
	Structural Adjustment Loan Program. Two loans for \$150 million and \$175 million already granted. Additional loans forthcoming if the Bank is satisfied with Bangkok's performance.	Raise public utility prices, improve industrial incentives, decrease import restrictions, take measures to promote rural development and raise rural incomes, increase tax revenues.	As part of earlier adjustment efforts, Bangkok removed most price controls, introduced new taxes, lowered some tariffs, and increased energy prices to world levels. It has put off fare increases for the bus and rail systems and has made little progress in agricultural development or industrial job creation.

of the public-sector budget deficit, which hit \$1.7 billion in FY 1982—4.5 percent of GNP. The principal cause was a 15-percent shortfall in income-sensitive taxes, especially trade taxes, and increases in government subsidies to unprofitable public enterprises. In 1982, Bangkok adopted a property tax, expanded the income tax, and imposed a 10-percent import tax in an unsuccessful attempt to contain the deficit. Restraints were also placed on the growth of government expenditures.

Despite these measures, Bangkok projects a \$2.2 billion deficit in FY 1983, which ends 31 August. The draft 1984 budget, passed by the Cabinet in June, calls for an 8.5-percent increase in expenditures, versus the 15 to 20 percent common in recent years. After adjusting for inflation, the budget contains no increase for salaries of civil servants or

for education and only 2- to 3-percent increases for other programs, including defense.

Bangkok also is under pressure from the IMF and World Bank to increase politically sensitive utility prices—especially transportation fares—in order to reduce government subsidies to unprofitable state enterprises. Public protests against higher bus fares late last year forced Prem to rescind the increase. We believe that new Communications Minister Samak, head of the populist Thai Citizens Party, will find it difficult to go along with higher bus fares for his Bangkok constituency. He recently proposed transferring control of the bus system from the national government to Bangkok city in an attempt to escape the responsibility for any fare increase, according to the Thai press. Samak is

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already facing a no-confidence vote engineered by the Thai Nation Party, the major opposition party, over his plans to raise passenger train fares in return for a \$110 million World Bank loan for railway expansion. [ ]

Energy prices may also present a problem for the new coalition. To ensure continued IMF/World Bank financing, Bangkok more than doubled energy prices between 1980 and 1982, bringing most prices up to world levels. In response to public pressure, however, Bangkok in late March reduced domestic petroleum prices by the equivalent of \$1.50 per barrel and lowered electricity prices by about 10 percent. The government is likely to come under pressure from populist politicians for further reductions. [ ]

Continuing low world prices for rice, sugar, tin, and rubber have depressed rural incomes. Large demonstrations in late November over low government rice support prices led Bangkok to agree to a higher price that it does not have the resources to meet. The Social Action Party—the dominant party in the new coalition—controls the Agriculture Ministry and intends to propose additional measures to raise prices paid to farmers. But such measures will be strongly opposed by Finance Minister Sommai because they will add to the government's budget deficit problems. [ ]

#### Longer Term Issues

Thai economic policymakers will also have to take a hard look at Bangkok's development plans for the 1980s. The labor force is projected to grow by about 700,000 a year for the remainder of the decade. The economy's job creation potential, however, even under the best of circumstances, will be much less. There is little additional land for new entrants to go into farming. Bangkok's emphasis on capital-intensive industrial development, despite rhetoric to the contrary, will produce relatively few urban, industrial jobs. Further expansion of the textile and garments industry, which dominates manufacturing exports, is limited by growing protectionist sentiment in major markets. And civil

service employment, the traditional sinecure of the well-educated, is currently frozen because of budget austerity and is unlikely to expand much over the decade. [ ]

Increased supplies of domestic natural gas, which will be used to fuel a heavy industry complex, are the keystone of Thai industrial policy. Based on projected gas flows of 20-23 million cubic meters per day from the Gulf of Thailand by late in the decade, Bangkok drew up plans to replace the imported fuel oil used in electricity generation with natural gas and to build a petrochemical and fertilizer complex using natural gas feedstocks, and explored the possibility of exporting liquefied natural gas (LNG). [ ]

Production shortfalls in Erawan, the only gas-producing field, make it appear that Thailand will fall short of its goal. The gas flow has averaged less than half the contracted 7 million cubic meters per day, not even enough to supply the newly converted Bangkok power plants. Union Oil, the operator of the field, now claims that Erawan's reserves are less than one-third of the originally estimated 45 billion cubic meters, because of fragmentation problems. Union also claims that other fields in the Gulf will probably exhibit similar problems and argues that the original estimate of reserves—some 280-340 billion cubic meters of natural gas—is substantially overstated. Because Erawan is only one of seven gasfields with proven reserves, however, we believe Thailand has sufficient natural gas supplies to continue reducing its dependence on imported fuel oil and to carry out a scaled-down version of its heavy industry complex. Bangkok's hardline negotiating strategy over gas pricing is hindering the development of additional fields. We believe neither Thailand's gas reserves nor world demand will support an LNG export project for the next decade. [ ]

Bangkok is also having difficulty attracting foreign investment for its planned energy and industrial development program. The development of export processing zones, with special privileges and incentives for investors, is just beginning, and Bangkok

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**Secret****Thailand: Eastern Seaboard Development Program <sup>a</sup>**

Project	Cost	Status
Infrastructure improvements	\$1.3 billion	Roads and communications links nearing completion. Port expansion under way.
Natural gas separation plant	\$200 million for each of two units. Japan and World Bank loans provide primary financing.	First unit under construction; completion scheduled for 1985.
Petrochemical complex	\$870 million	Bangkok is having trouble recruiting private investors and may have to increase its participation. Olefins plant scheduled for completion in 1987.
Fertilizer plant	\$500 million	Construction scheduled to begin in late 1983.
ASEAN soda ash plant	70-percent Japanese financing	Feasibility study concluded the project would be unprofitable and implementation is doubtful.
Light industry development	No estimate	Bangkok is counting on private-sector initiative for both light industry and tourism development.
Expansion of tourist facilities	No estimate	

<sup>a</sup> The centerpiece of the Eastern Seaboard Development Plan (ESDP) is a \$4 billion industrial complex located between Rayong and Sattahip. Government plans also include development of a labor-intensive, export-oriented sector centered at Laem Chabang and expansion of tourist facilities centered at Pattaya. The ultimate hope is to turn the eastern seaboard into an industrial alternative to overcrowded Bangkok.

has made little progress in streamlining foreign investment procedures. Moreover, Industry Minister Ob's recent ruling banning the establishment of firms whose production may compete with companies promoted by the Board of Investment will—if enforced—reduce the attractiveness of foreign investment.

Finally, Bangkok has not seriously addressed the question of rural development. Thai economic policy over the past 20 years has favored urban and manufacturing interests over agriculture, which remains the backbone of the economy. Over two-thirds of the labor force is employed in agriculture, and agricultural exports still provide more than 60 percent of export earnings. Measures to keep urban food prices and thus urban wages low have depressed farm incomes and discouraged investment in high-yield seeds, fertilizer, and irrigation facilities. As a result, urban incomes are more than double those in rural areas, according to the World Bank, and the divergence is growing. Although most of the arable land is under cultivation, there is much room for improvement in agricultural yields, among the lowest in Southeast Asia. Government measures leading to gains in real income for farmers will be required if they are to undertake the spending necessary to increase yields. Some analysts believe that even with increased incomes many Thai farmers lack the motivation to increase production. Despite rhetoric by Thai officials endorsing rural development—reiterated in Prem's policy statement to parliament in May—we have seen little effective reorientation of development priorities or funding. We believe a continuation of Bangkok's policy of slighting the rural sector will accelerate rural-urban migration and add to pressures for more jobs in the urban sector.

**Political Constraints on Economic Progress**

In response to advice from the World Bank and its own technocrats, Bangkok has made some progress in reorienting its economy to regain its growth

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momentum. A measure of financial liberalization has increased the domestic incentives to save and invest. Most energy prices have been adjusted to world levels, while a number of tariffs have been cut and further reductions are scheduled. The retention of senior technocrats and Finance Minister Sommai indicates Prem's basic support for the World Bank program. [REDACTED]

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Further substantial economic reform will be difficult to implement, however. Although Prem's four-party coalition government has a clear majority in the National Assembly, poor relations among the leaders of the coalition parties will keep it factionalized and politically unstable. The division of the economics ministries among three of the coalition partners reduces the chances of obtaining a consensus on economic reforms. [REDACTED]

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Because the governing coalition remains somewhat shaky, we expect it to back down from, or postpone, many unpopular economic decisions. Although international financial institutions will be pressing for budget austerity and utility price increases, we believe Bangkok will move slowly on these politically sensitive issues. Improved external finances would allow Thailand to replace some IMF and World Bank loans with commercial funding, albeit at higher interest rates. Doing so, however, would adversely affect Thailand's international creditworthiness and attractiveness to foreign investors. [REDACTED]

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Even if the new government wished to change the direction of economic policy or accelerate the pace of reform, moreover, it would run into opposition from the influential business community, elements of the military, and the bureaucracy. These groups have generally opposed liberalization of import and foreign investment restrictions, as well as a shift in emphasis from industrial to agricultural development. [REDACTED]

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## Hong Kong: Deteriorating Economic Conditions

The economic climate in Hong Kong has deteriorated sharply during the past two months, largely because of waning investor confidence in the face of a Chinese takeover in 1997. The Hong Kong dollar broke the psychological barrier of HK\$7/US\$1 in May and has continued to weaken despite government open-market intervention and a 2-percentage-point increase in interest rates. The Hong Kong stock index, which had been on an upward trend since last November, turned sharply downward in May. Efforts to rescue several failing financial companies and three large property concerns are also meeting little success.

Short-term prospects for an economic rebound are nevertheless good. Speculative pressure against the currency has shown signs of easing somewhat, and Hong Kong exports have begun to respond to Western economic growth. Inflation, however, will remain a major problem owing largely to the currency depreciation. Over the next five to seven years, the continuing political uncertainty surrounding 1997 will restrain economic growth and deepen economic downturns. We expect cyclical fluctuations to become more severe unless Britain and China can work out an arrangement that leads to a smooth takeover. The currency will probably continue to weaken, and the Hong Kong stock market will reflect increasing investor uncertainty.

### Current Economic Situation

Hong Kong began 1983 with most major economic indicators improving. Exports—the traditional engine of growth in the colony—were up an estimated 5 percent in real terms during the first four months after a 2-percent decline in 1982. Bankruptcies, mostly tied to the major slump in the property market last year, were easing somewhat as residential buyers returned to the market. Reflecting the

overall improvement, the major stock index climbed 30 percent from 1 January to 30 April of this year.

Despite these positive indications of economic recovery, the local currency has been gradually losing foreign purchasing power since January of this year. The strengthening US dollar probably accounts for much of the early decline; most other Asian currencies were also losing ground during this period. But waning investor confidence took over in early May, cutting more than 5 percent off the currency's value against 15 major currencies and nearly 10 percent off its value against the dollar in a one-month period. The currency strengthened only slightly in June.

### The Chinese Specter

China plans to take control of Hong Kong in 1997—when the British lease expires—and local investors are jittery about economic prospects under a Communist regime. Although Beijing has gone to great lengths to publicize its intention to leave the colony's social and economic status quo unchanged after takeover, local businessmen remain unconvinced. Moreover, talks between London and Beijing, which most Hong Kong residents hoped would bring some form of continued British presence in the colony after takeover, have not gone well.

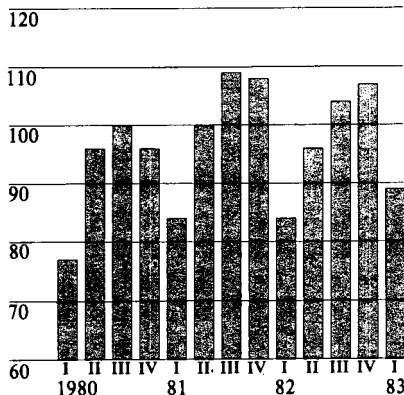
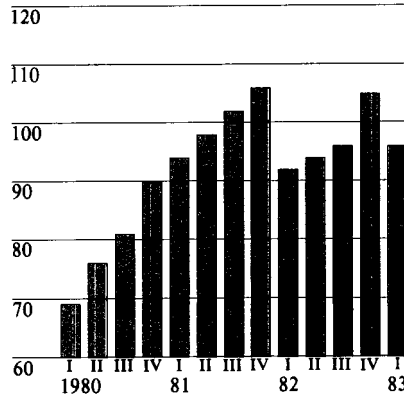
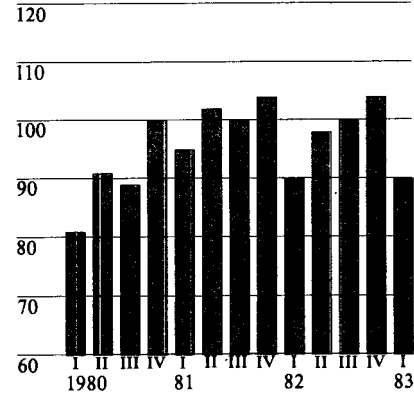
No data for capital flight are available. Bankers in Singapore, Thailand, Sri Lanka, the United States, and Canada reported increased inflows of Hong Kong capital late last year when a similar bout of nervousness sent the Hong Kong dollar into a less severe tailspin. These same countries were probably major recipients during the most recent scare. In

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**Secret****Hong Kong: Volume of Trade**

Index: 1981=100

**Exports****Reexports****Imports**

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addition, local savers are shifting out of Hong Kong dollar deposits in favor of foreign currencies and gold. We estimate that about 60 percent of Hong Kong bank deposits are now being held in foreign currencies compared with 38 percent a year earlier. Although data for 1983 gold imports are unavailable, purchases from Western Europe reportedly jumped 50 percent in 1982 to more than 135 tons.

**Government Attempts To Restore Stability**

Thus far the Hong Kong Government's efforts to stem the currency outflow and to bolster sagging confidence have met with little success. The government probably attempted to support the currency with small-scale open-market purchases of Hong Kong dollars in mid-May and early June; with only an estimated \$3-4 billion in its foreign currency reserve fund, long-term, large-scale intervention is impossible. By midmonth the government resorted

to a more drastic measure to halt the outflow, pressuring the Hong Kong Association of Banks (HKAB) to raise interest rates 2 percentage points. HKAB's announcement of the upcoming rate increase bolstered the dollar for only two days, however. By the time the increase went into effect, the dollar was once again sinking to new lows.

Nor was its failure to halt the downward slide of the currency the only negative aspect of the rate increase. Hong Kong's always volatile stock market plunged 5 percent in one day as a result of investor fears that the rate increase would stymie economic recovery. Two of Hong Kong's largest textile manufacturers are among the many industrial firms currently attempting to stave off bankruptcy with short-term borrowing. Major property companies—among the biggest investors in the Hong Kong stock market—are also in need of significant amounts of short-term funds.

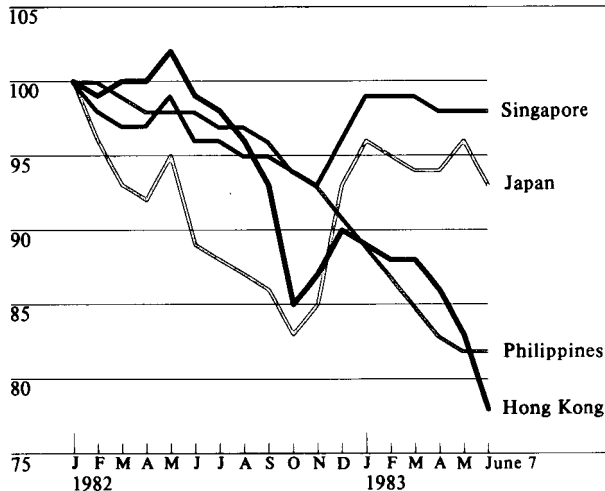
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**Foreign Exchange Rates for Selected Countries<sup>a</sup>**

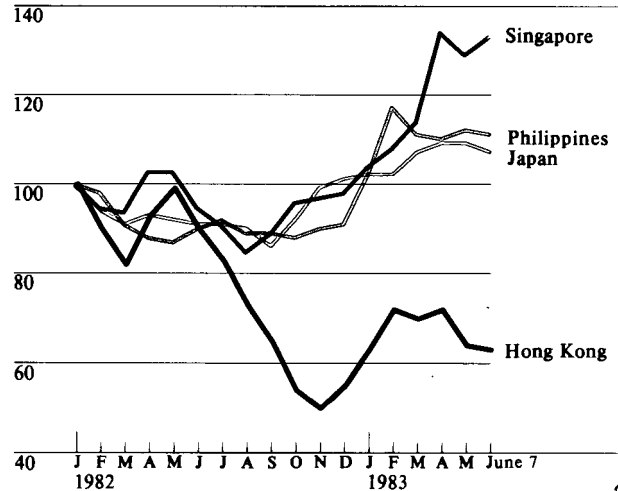
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<sup>a</sup> Average monthly rate, in dollars per unit of currency.

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**Stock Market Indexes for Selected Countries<sup>a</sup>**

Index: Jan 1982=100

<sup>a</sup> At end of month.

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**Outside Support**

The largest foreign holder of Hong Kong currency is probably China's official foreign exchange bank—the Bank of China. Although no data are available on total bank holdings, Beijing's exports to Hong Kong in 1982 amounted to \$5.4 billion, almost entirely paid for in Hong Kong dollars. Indeed, according to a Chinese research institute, nearly one-third of China's annual foreign exchange earnings come from Hong Kong. The holdings have put Beijing into a difficult situation. By holding Hong Kong dollars, Beijing is suffering a sizable loss in purchasing power. Converting to foreign currency, however, would exacerbate the decline in the Hong Kong dollar and could contribute to instability that Beijing is trying to discourage.

Hong Kong could probably also turn to the Bank of England for support. Although such a move would be unprecedented, we believe that the Bank would be willing to work out some type of swap arrangement if the economic deterioration was deemed extreme. Bank of England support would probably give investor confidence a major boost and, at least temporarily, could discourage speculative pressure on the currency.

**Prospects**

In the short run, we believe Hong Kong's prospects for economic recovery are good. During the past

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few days, the currency has shown signs of leveling off at about HK\$7/US\$1. Stronger-than-expected recovery in the West bodes well for sharp increases in exports this year. Major gains in the export sector would bolster confidence colonywide and could contribute to overall economic stability during the remainder of the year. With the 1997 deadline still 14 years away, investors probably continue to see sizable short-term opportunities in the Hong Kong market. Although the recent hike in interest rates will hinder growth somewhat, we expect GDP to rise 5 percent this year. Unemployment should fall below its current peak of 5.1 percent to perhaps 3 to 4 percent. [REDACTED]

Because the colony is totally dependent on imports for food, energy, and industrial raw materials, we expect the recent depreciation will hamper efforts to arrest inflation. Gasoline prices jumped nearly 2 percent in May alone, and other increases are imminent. By yearend the consumer price index will probably be at least 15 percent above the year-earlier level. In fact, the price increase will probably offset any beneficial effect of the exchange rate depreciation on Hong Kong exports. Although the currency should regain some of the ground lost recently, we do not expect it to approach the 1982 average rate of HK\$6/US\$1. [REDACTED]

As long as residents remain uncertain about the colony's future, long-term economic prospects for Hong Kong remain gloomy. A large number of the colony's residents are making efforts to get at least one member of their immediate family established overseas; Hong Kong's most highly trained workers are likely to be among the most successful in leaving the colony. Moreover, investors, even those publicly praising the current Chinese leadership and its policies, are diversifying their investments and moving capital offshore. [REDACTED]

The drain on investment funds and skilled workers will constrain Hong Kong's long-term growth. Over the next few years, we expect that Hong Kong's growth rate will fall short of historic levels and probably remain well below rates being achieved by

its traditional competitors in the area. Growth is also likely to be erratic, reflecting swings in investor uncertainty. [REDACTED]

We believe that, in the long run, the floundering economy will pressure Beijing to exhibit flexibility in negotiations with the British. At present, however, Beijing appears convinced that it can pacify Hong Kong investors and maintain economic vitality without a significant British presence and, hence, will probably continue to take a hardline approach. Beijing's recognition that this approach is causing severe problems and modifications in Chinese demands might not, however, come until investor confidence in Hong Kong has been irreparably damaged. [REDACTED]

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## Spain: The Challenge of Entry Into the European Community

Spain's Socialist government is pressing EC leaders to accelerate negotiations on Spain's entry into the Community. The Ten have been unable to agree on increased budgetary contributions and reforms of the Common Agricultural Policy (CAP) that must precede EC enlargement. The scope of this dissension probably precludes accession before early 1986, a delay that would vex Spanish officials. In fact, frustration already has led Madrid to suggest that it might reconsider its bid if sufficient progress has not been made by next year. We believe, however, that a growing appreciation in Madrid of the potential benefits of membership—despite some possible dislocations in the short run—will sustain the government's commitment to the process of application.

If Spain does join the EC, the repercussions on its economy will be considerable. The liberalization of trade following accession will both open up Spain's highly protected economy to increased foreign competition and provide Spanish exporters with greater access to EC markets. In order to prepare for entry into the Community, however, the ruling Socialists face the daunting prospect of restructuring industry, agriculture, and finance. This task will be all the more difficult because reforms will have to be instituted at a time when industry is still suffering from the world recession and the unemployment rate has reached 18 percent.

### Removing Barriers to Trade

As part of the EC, Spain will be required to remove import barriers against the other members, abolish subsidies and tax rebates on its exports to them, and adopt the common external tariff (CXT) on imports from third countries. Madrid's acceptance of these rules of membership will drastically reduce

the levels of protection its various industries currently enjoy. Under the terms of the 1970 trade agreement with the Community, Madrid promised to lower its tariffs by an average of 25 percent, while EC members agreed to reduce tariffs by 60 percent. IMF calculations indicate that Spain's average tariff on EC goods is currently 13.3 percent, versus an average EC tariff on Spanish products of only 3.3 percent. Similarly, Madrid's tariffs on goods from third countries average about 17 percent—more than 12 percentage points above the average CXT.

The EC Commission and Madrid agree that Spain's protective measures should be dismantled gradually in order to minimize the shock to its economy. However, there is no agreement yet on the length of the transition period or the size of the annual tariff reductions. The Gonzalez administration has requested a 10-year transition period for lowering tariffs, whereas the Commission has recommended a seven-year period. Under the terms of a recent Spain-EC agreement on import quotas, Madrid will be permitted to maintain existing quotas on a number of sensitive items, generally for four years.

### Impact on Spanish Industry

Whatever the eventual compromise, it will expose Spanish manufacturers to more intense competition. High protective barriers have encouraged a lower degree of specialization and a larger number of small firms within each sector than in the EC. Over 90 percent of Spanish firms employ fewer than 25 people. The value added per employee and the volume of sales per employee are less than half

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**Secret****Spain: Trade With the European Community, 1980**

	Exports (million US \$)	Share of Spanish Exports by Commodity (percent)	Imports (million US \$)	Share of Spanish Imports by Commodity (percent)
<b>Total</b>	<b>10,195</b>	<b>48.9</b>	<b>10,419</b>	<b>30.7</b>
Foodstuffs	2,083	48.4	717	16.0
Of which:				
Fruit	1,013	81.0	13	12.6
Vegetables	509	68.0	44	48.8
Wine	249	61.7	2	77.4
Olive oil	58	24.9	0	0
Dairy products	1	2.2	106	80.9
Cereals	5	7.2	77	8.3
Meat	19	30.6	51	36.9
Raw materials	874	57.8	1,027	34.0
Fuels	325	37.3	439	3.1
Manufactures	6,908	40.0	8,195	61.6
Of which:				
Footwear	316	56.3	13	35.1
Textiles	294	46.2	195	55.1
Leather	237	72.9	24	26.1
Paper	127	39.4	129	42.4
Wood	30	38.8	60	11.8
Steel	457	24.7	588	80.3
Machinery	1,111	43.7	2,948	64.3
Chemicals	608	37.8	1,682	61.5
Transport equipment	1,952	69.5	1,049	70.4
Other	5	15.6	41	73.9

EC levels. This implies that many Spanish companies operate at a disadvantage compared with the larger European corporations and that, unless mergers or acquisitions take place, some small firms may be driven out of the market by more efficient competitors.

The eventual removal of the import barriers poses a particularly serious threat to Spain's textile, steel, shipbuilding, and electrical appliance and components industries. These industries have been protected by quantitative restrictions, subsidies, and

import tariffs that in some cases are over 30 percentage points higher than the tariffs imposed by the Community.

The detrimental effects of EC membership on the industries vulnerable to foreign competition may be only partly offset by the growth of export industries in the near term. Since EC tariffs on Spanish imports are already quite low and since Spanish

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manufacturers will lose the benefit of export subsidies and tax rebates, the stimulus to export industries may be limited. Moreover, Spanish wages are close to those in the member countries while labor productivity is less than half the EC level. Until traditional labor-intensive export industries, such as footwear, leather, and clothing, bring in more modern equipment and quality control, they are likely to have a low potential for expanding sales to the Community. In the long run, their performance depends on the Socialists' success in restructuring and persuading workers to accept a drop in real wages. [ ]

In order to enhance the ability of Spanish firms to compete eventually with European multinationals, Madrid is developing plans to modify the four-year industrial reconversion program introduced in 1981. The Socialists intend to continue the previous government's efforts to reduce capacity, eliminate job redundancies, increase investment, and provide financial assistance but also propose to restructure these sectors and reallocate resources to those producers with a better chance of surviving in the international market. In some cases, this approach will necessitate closing firms. At least two steel mills will be closed under the Ministry of Industry's proposal to cut production to 7.7 million tons and to raise the efficiency of the steel sector. Similarly, the government will offer assistance to only a limited number of firms manufacturing domestic appliances. [ ]

According to a Spanish Government study, the social costs of restructuring will be high—more than 20 percent of the existing jobs in the affected sectors may be eliminated. An even larger share of the work force could be trimmed after accession if Madrid is obliged to adhere to the EC's restructuring programs. Although government officials have promised to create a program to retrain displaced laborers, the unemployment rate probably will continue to rise. [ ]

Recognizing the weaknesses of both traditional labor-intensive industries and small plants, the Socialists are encouraging foreign investment. For example, since Madrid has little time to foster the

growth of its infant electronics industry, it has persuaded several Japanese firms to buy into Spain's electronics industry. The prospect of using the protected domestic market as a springboard to the EC has also prompted General Motors to locate a new plant in Spain. Madrid's continued ability to attract foreign capital will not only diversify its export market but also provide the managerial expertise and technology that its domestic industry needs. [ ]

#### **Agriculture: The Common Agricultural Policy**

Spain's adherence to the CAP will have a mixed impact on the country's farming sector. Some products will be subject to greater competition. In the highly protected olive oil sector, this will lead to increased domestic consumption of cheaper vegetable oils and exacerbate the existing olive oil surplus. Madrid will also be obliged to buy agricultural commodities from the Ten at EC market prices, boosting its food import bill. Furthermore, some agricultural purchases from non-EC members will be subject to an import levy to bring their price up to the EC level. According to an EC Commission proposal, Madrid will be permitted to retain the proceeds of the levies during the initial transition period. Subsequently, this money will be transferred to the Community as part of Madrid's contribution to the budget. Since about 80 percent of its agricultural imports originate outside the EC, Madrid has estimated that its import levies could be close to \$700 million. [ ]

Despite these obstacles, Madrid could achieve both a net inflow of EC funds and a small agricultural trade surplus. Madrid may be able to counterbalance its contribution to the common agricultural fund by obtaining a combination of export subsidies, regional development assistance, and special subsidies for domestic producers. The Spanish Ministry of Finance calculates that net transfers from the EC will total \$440 million to \$525 million. Spain also should be able to increase its agricultural exports to the Community once the present tariffs, reference prices, and import schedules for

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Spanish produce are lifted. The price competitiveness of Spanish agricultural goods, reflecting relatively low farm wages and transport costs, suggests that Spanish exports could displace produce from Israel, the Maghreb, France, Italy, and Greece on the EC market. [ ]

Accession will force Madrid to revamp its approaches to market intervention and price supports. Whereas Brussels purchases surpluses of key agricultural products when the market price falls below the desired level, Madrid currently negotiates the range of minimum and maximum prices for principal agricultural products with the farm federations and labor unions and provides permanent assistance to support these prices. As in the EC, intervention prices do not apply to most fruits and vegetables. In anticipation of the changes that must follow accession, Madrid intends to abolish the state monopoly, the National Service for Agricultural Products (SENPA), and to model its market intervention system on the CAP. The Socialists will also continue past efforts to bring agricultural price supports into line with generally higher EC intervention prices. [ ]

The Ministry of Agriculture is also preparing to alter the structure of the agricultural sector in order to conform to EC regulations. Like other members of the Community, Spain needs to reduce its large surpluses of wine and olive oil. Consequently, the government proposes cutting the area planted to wine grapes by 25 percent—taking 200,000 hectares out of production entirely and converting an additional 200,000 hectares of vineyards to the production of other crops. Similar measures will decrease the production of olive oil. In fact, 70,000 hectares of olive trees have already been plowed under. [ ]

### **Fisheries**

EC and Spanish negotiators have not yet addressed the fisheries question. When they do, progress is likely to be slow because of the size of the Spanish fishing sector. Madrid's fishing fleet is more than half as large as the combined fleets of the EC

countries; Spanish fishermen number 70 percent of the total in the Ten. Madrid reportedly intends to begin rationalizing its fishing industry, but this will do little to reduce the threat posed to the Community. Moreover, a paper prepared by the EC Commission indicates that Spain may attempt to obtain a preponderant share of the Community's annual quota. According to the study, Madrid might claim access to waters it fished until barred by EC regulations. The study also suggests that Spain might seek preferences as a coastal country and compensation for the loss of fishing licenses in third countries. We expect that the Ten will try to prevent the immediate integration of Madrid's fishing sector in order to protect their own industries. [ ]

### **Banking Reform**

EC membership would expose the Spanish banking system to intense competition, because the existing restrictions on foreign banks would have to be eliminated. Under present Spanish law, foreign banks must provide five times more paid-in capital than domestic banks to open a branch, and the number of branches they can open is limited. Moreover, foreign banks are permitted to invest only in fixed-interest bonds and public securities. [ ]

The possibility of an influx of foreign banks has helped to focus attention on the weakness of the Spanish banking system. Policymakers are aware that existing laws have permitted the proliferation of small, inefficient, and even unsound branches. A recent proposal to curtail new branches falls well short of the needed restructuring. Unless mergers and acquisitions occur, the small scale of the present banks suggests that they will have difficulty competing with international banks. [ ]

### **Outlook**

Both the preaccession and transition periods seem likely to produce some economic and social strains.

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Restructuring and rising imports will probably lead to dislocations and the loss of jobs in both industry and agriculture. The government will have to resist union pressure to preserve jobs in inefficient industries. In the long run, the reallocation of resources and the disappearance of weak, inefficient industries is both a necessary and positive step, whether Spain joins the Community or not.

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Madrid may also have to contend with a growing trade deficit in the short run. The mutual reduction of tariffs and quantitative restrictions will stimulate Spanish imports of EC manufactured goods, while the current Commission proposal to deny Spanish fruits and vegetables free access to the Community during the first four years of membership will delay the expected boost to agricultural exports. Over the longer run, the prospects for Spain's trade balance should be more favorable, as Spanish industry responds to the stimulus of increased competition and as agricultural trade is liberalized. Since the European Community is Spain's largest trading partner by far, this promise will probably be sufficient to keep Madrid on the track toward accession even if the negotiations drag on into 1985.

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